

Message Text

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ACTION NEA-09

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TRSE-00 SS-15 STR-01 OMB-01 CEA-01 CIAE-00 COME-00

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FM AMEMBASSY ABU DHABI

TO SECSTATE WASHDC 2567

INFO AMEMBASSY JIDDA

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C O N F I D E N T I A L ABU DHABI 0322

E.O. 11652: GDS

TAS: EFIN, EAID, EINV

SUBJ: POSSIBLE EFFECTS OF PRODUCTION CUTS ON ABU DHABI

REF: ABU DHABI A-8, JANUARY 23, 1975

SUMMARY: ABU DHABI FINANCE OFFICIALS ESTIMATE TOTAL GOVERNMENT REVENUE FOR CALENDAR YEAR 1975 AT 3.5 BILLION DOLLARS, THE SAME AS 1974. THIS ESTIMATE BASED ON HIGHER PRODUCTION LEVEL THAN CURRENT RATE OF 700,000 BPD. REVENUE CONSTRAINT, COUPLED WITH INCREASED DEMANDS FOR PUBLIC EXPENDITURE INDICATES ABU DHABI WILL NOT ENJOY THE SAME DEGREE OF FINANCIAL FLEXIBILITY AS IN 1974, WITH PARTICULAR PRESSURE ON ABU DHABI'S FOREIGN INVESTMENT AND ASSISTANCE PROGRAMS. END SUMMARY.

1. FOREIGN ADVISORS IN ABU DHABI DEPARTMENT OF FINANCE AND PLANNING ARE DISPLAYING CONCERN ABOUT STATE OF ABU DHABI'S PUBLIC FINANCES. FOR SOME TIME, THESE ADVISORS SAY, THEY HAVE BEEN PRESSING FOR ESTABLISHMENT OF PRIORITIES TO GUIDE EXPENDITURES. IN 1974, SUCH ADVICE FELL ON DEAF EARS, BUT IT MAY BE ESSENTIAL IN 1975. ONE ADVISOR BELIEVES THAT IF
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NO RESTRAINT IS EXERCISED IN EXPENDITURES AND UNDERTAKING

OF NEW FOREIGN AID AND DEVELOPMENT COMMITMENTS, ABU DHABI
MAY REPEAT QUOTE THE RECESSION UNQUOTE OF 1969-1970.

2. AS REPORTED IN REFAIR, IF JANUARY PRODUCTION RATES
CONTINUE THROUGH 1975, GOVERNMENT OIL REVENUE WOULD FALL
TO DOLLARS 3.1 BILLION. FEBRUARY PRODUCTION HOWEVER APPEARS
HEADED FOR EVEN LOWER LEVELS. REVENUE CONSTRAINT WOULD BE
EASED BY REDUCTION IN SULFUR DIFFERENTIAL AS WELL AS OTHER
POSSIBLE DISCOUNTS WHICH GOVERNMENT NOW CONTEMPLATING.
BUT THE LONGER THIS DECISION IS DELAYED, THE MORE PRODUCTION
WILL HAVE TO INCREASE TO BRING REVENUE BACK UP TO 1974
LEVELS. BECAUSE OF THE LAG IN TAX PAYMENTS, INCREASED
PRODUCTION CAN HAVE IMPACT ON REVENUE ONLY IF INCREASE
OCCURS BETWEEN NOW AND END OF OCTOBER.

3. ON EXPENDITURES, CONSTRAINTS WOULD HAVE BEEN APPARENT
EVEN ASSUMING THE VALIDITY OF THE 3.5 BILLION DOLLAR REVENUE
PROJECTION. JOHN BUTTER, DEPARTMENT OF FINANCE, BELIEVES
GOVERNMENT'S PRIORITIES SHOULD BE: ABU DHABI FIRST,
SUPPORT FOR THE OTHER EMIRATES THROUGH UAE BUDGET SECOND,
AND FOREIGN ASSISTANCE THIRD. WHETHER HIS ADVICE WILL BE
ACCEPTED REMAINS TO BE SEEN. CERTAINLY, HIS PRIORITIES WILL
NOT TAKE EFFECT IMMEDIATELY. IN PARTICULAR, MINISTRY OF
FOREIGN AFFAIRS SOURCES SAY THAT FOREIGN ASSISTANCE
EXPENDITURES (BASED ON COMMITMENTS, WHICH, OF COURSE,
CAN BE STRETCHED OUT) WILL REACH AT LEAST 1.2 BILLION
DOLLARS IN 1975 AND MAY POSSIBLY BE AS HIGH AS 1.5 BILLION.
ASSUMING 1975 REVENUE AT 3.5 BILLION, THIS WILL LEAVE ABOUT
2.0-2.3 BILLION FOR DEVELOPMENT AND RECURRENT BUDGETARY
EXPENDITURES, AN AMOUNT EQUIVALENT TO 1974. BUT ABU DHABI'S
DEVELOPMENT PLANS FOR 1975 AND 1976 ARE AMBITIOUS, INCLUDING
THE CONSTRUCTION OF A SECOND AIRPORT AND EXTENSION OF THE
PORT FACILITIES. MOREOVER, THE OTHER EMIRATES OF THE UAE
ARE DEMANDING AN INCREASED SHARE OF DEVELOPMENT FUNDS.

4. ALTHOUGH IT MAY BE POSSIBLE TO CUT NON-ESSENTIAL
PROJECTS (SUCH AS REFORESTATION) FROM THE DEVELOPMENT BUDGET,
IT IS CLEAR THAT GREATEST IMPACT OF TIGHT REVENUE SITUATION
WILL BE ON ABU DHABI'S FOREIGN INVESTMENT. IF PRODUCTION
REMAINS DOWN, IT IS HIGHLY LIKELY THAT NEW FOREIGN INVEST-
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MENT IN 1975 WILL COME TO A TRICKLE. WHAT INVESTMENT DOES
OCCUR WILL REPRESENT PLACEMENT OF WINDFALL REVENUE, SWITCHING
FROM ONE PORTFOLIO ASSET TO ANOTHER, OR INVESTMENT OF REMAINING
SURPLUS 1974 FUNDS. IN SHORT, UNLIKE SOME OTHER OPEC
COUNTRIES, ABU DHABI WILL BE UNABLE TO DEVELOP A LONG-
RANGE INVESTMENT STRATEGY. INVESTMENT WILL BE
OPPORTUNISTIC USING FUNDS NOT NECESSARY TO CURRENT
GOVERNMENT OPERATIONS.

5. TO SOME EXTENT, THIS INVESTMENT APPROACH PREVAILED ON A LARGER SCALE IN 1974. ABU DHABI'S ONE BILLION DOLLAR REVENUE SURPLUS WAS ALSO IN NATURE OF A WINDFALL. IN JANUARY 1974, BUTTER ESTIMATED REVENUE AT 2.5 BILLION AND EXPENDITURES AT 2.2 BILLION. BY END OF JUNE, IT WAS EVIDENT TO EVERYONE (EVEN BUTTER) THAT ABU DHABI WOULD HAVE SIZEABLE SURPLUS. BECAUSE OF ITS WINDFALL NATURE, IT IS NOT SURPRISING THAT INVESTMENT BOARD HAD PREFERENCE FOR HIGHLY LIQUID SECURITIES AND NEVER DID DEVELOP AN OVERALL INVESTMENT POLICY.

6. ANOTHER ALTERNATIVE MAY EMERGE IN 1975. THERE MAY BE SOME TENDENCY TO COMBINE FOREIGN INVESTMENT WITH GOVERNMENT'S BILATERAL FOREIGN ASSISTANCE PROGRAM. RATHER THAN CONTINUE WITH DIRECT LOANS (WITH RATES OF INTEREST RANGING FROM 2-9 PERCENT), GOVERNMENT COULD BEGIN TO TAKE EQUITY POSITIONS IN INDUSTRIAL PROJECTS IN LDC'S. RECENTLY ANNOUNCED INDUSTRIAL COOPERATION AGREEMENT WITH MOROCCO MAY BE LEADING EDGE OF SUCH STRATEGY. TWO COUNTRIES WILL ESTABLISH JOINT VENTURE COMPANIES TO MINE AND PROCESS MOROCCO'S PHOSPHATE RESERVES. LOCAL SOURCES ESTIMATE RETURN ON ABU DHABI CAPITAL AT 25 PERCENT.

7. REGARDLESS OF POSSIBLE CONSTRAINTS OF LIMITED REVENUES, WHETHER THIS DIRECT INVESTMENT STRATEGY WILL RECEIVE GREATER EMPHASIS IS TO LARGE EXTENT DEPENDENT ON RELATIVE POLITICAL CLOUT OF TWO PROMINENT ADVISORS. ON ONE HAND, HASSAN ABBAS ZAKI, DIRECTOR OF ABU DHABI FUND FOR ARAB ECONOMIC DEVELOPMENT (BUT NOT A MEMBER OF THE INVESTMENT BOARD) AND ON OTHER, JOHN BUTTER, WHO IS MORE SENSITIVE TO UNCERTAINTY OF ABU DHABI'S REVENUE AND MORE CONSERVATIVE IN HIS INVESTMENT PHILOSOPHY. CONFIDENTIAL

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